(14)

IN THE

Supreme Court of the United States

October Term, 1944.

No. 1079 128

H. LEWIS BROWN

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner, H. Lewis Brown, prays that a writ of certiorari issue to the United States Circuit Court of Appeals for the Second Circuit, which affirmed a decision of the Tax Court sustaining the respondent to the extent of $21,568,* in levying an additional assessment of $25,774, with respect to petitioner's income for the year 1937.

Opinions Below.

The opinion of the Circuit Court of Appeals is reported at 141 F. (2d) 307; that of the Tax Court at 1 T. C. 760.

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* Fraction of a dollar neglected here as elsewhere herein, including quotations.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938, U. S. C. Title 28, Section 347) and Section 1141 (a) of the Internal Revenue Code.

The judgment to be reviewed was entered on March 7, 1944 (No. 189, October Term, 1943).*

Statement.

Petitioner, as surviving partner in a law firm of two members, collected a fee of $228,068 in October, 1937, for services rendered partly by the partnership and partly by petitioner as surviving partner. The partnership agreement provided that the estate of a deceased partner should share in the income of the office for a period of six months after death, also that "as to work being done by the firm at the time of dissolution, whether pursuant to notice or six months after death of one of the partners" (123), compensation should be divided on the basis that the firm would receive "such part thereof as will fairly represent the value of the service rendered during the existence of the firm, having in view the amount and character of such service as compared with the entire service", and the partner completing the service after dissolution would be entitled to the rest (123).

The said fee was for services rendered on behalf of the plaintiff in a patent infringement suit that had been commenced in the year 1920 and was terminated in 1937. In January, 1929, the firm made a contract with the client for

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* Opinion below filed February 17, 1944. Rehearing petition filed Friday afternoon, March 3, 1944, denied Monday morning, March 6, 1944 (151, 160).

the continued prosecution of the claim on the basis of an annual fee certain and a percentage of the recovery (124). The petitioner's partner, the late A. H. Burroughs, died on June 19, 1929 (115).

Because of the long period covered by the service, the complicated nature of the case, and a difference of opinion as to the period of time covered by the fee contract, which had a crucial bearing on the relative rights of petitioner and the estate, petitioner and the estate of his partner did not come to an agreement until April 27, 1938, as to a division of the fee.* It was conceded that petitioner was entitled to at least one-half ($114,032) of the fee and petitioner conceded that the estate was entitled to as much as $7,982 out of the other half, so that at the end of the year 1937, the balance of the fee remaining in petitioner's hands for discussion and division was the sum of $106,050, petitioner contending that the period of the firm's interest was a period of 11 months, starting from the date of the fee contract, and the estate claiming that the period of the firm's interest was approximately 10 years, starting from the inception of the litigation.

The basic question is:

> What part of that portion of the fee that remained in dispute at the end of the year 1937, namely, $106,050, is lawfully taxable to petitioner as part of his 1937 income?

On March 10, 1938, the estate for the first time (50, 51) stated its claim in dollars. It then made a demand on petitioner for $46,052 as its share. By agreement entered into on April 27, 1938, the estate's interest in the entire fee was fixed at $14,995 (51, 134-40 at 139). In that settlement

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* This delay was due to no connivance on the part of either party, so held by both courts (50, 93, 98, 149, notes 2, 3).

petitioner and the estate discarded their claims of 11 months and 10 years, respectively, for period of joint interest and by way of compromise agreed to consider the period of joint interest as running from October 15, 1925, and covering a period of 50 months, which was only a compromise figure, with no basis for support under the facts.* As a result, it was agreed that the estate should receive a total of $14,995.

The Commissioner's Position.

The Commissioner in his assessment letter stated that careful consideration had been given to the field agent's report, to petitioner's protests of June 21, 1939, August 2, 1940, October 30, 1940, and December 5, 1940, to statements made at seven designated conferences and petitioner's claim for refund filed February 26, 1940 (8), and his conclusion was that "the entire contingent fee of $228,068 less $6,816, the amount ultimately paid to the Estate of Ambrose H. Burroughs (Deceased) under a former partnership agreement for the period prior to his death, is held to constitute income to you for 1937 under section 22(a) of the Revenue Act of 1936" (9). The figure of $6,816 announced by the Commissioner is 5/11 of $14,995 and reflects the Commissioner's adoption of a period of 11 months for the period of joint interest. The Commissioner thus charged petitioner with the entire fee ($228,068), less the agreed settlement figure ($14,995), plus the 6/11 thereof allocated by him to the 6-months period

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* The estate's position of 10 years of participation was based on the inception date (1920) of the litigation as a starting point. Petitioner's position of 11 months took the date (January, 1929) of the fee contract as the starting point. Under the documents and the evidence it had to be either the 10 years or the 11 months. The compromise figure of 50 months was only a compromise and had no factual basis whatever to support it.

after death (51, 53, 54, 61, 147, note).* On the other hand, the settlement agreement was predicated on an agreed compromise period of 50 months of joint interest and the compromise figure of $14,995 therein arrived at was built up on an arbitrarily agreed basis of the three elements in the contract, namely, (a) period of joint interest, (b) amount of and (c) character of work done in the relevant periods. The only one of these three factors definitely segregated in the agreement was 50 months for the period of joint interest. The Commissioner ignored this, the only item identifiable in amount, changed it to 11 months and held to the same result. *The Commissioner failed to give any effect to the situation as it existed at the end of the taxable year, although his letter disclosed that he was fully provided with all the relevant facts as of that time* (8).

The Position of the Tax Court.

The Tax Court, like the Commissioner, failed to give any effect to the facts as they existed in 1937. In the official headnote prepared by the court, in referring to the settlement agreement, it is said:

> "(1) Retroactive effect will be given to this agreement in determining petitioner's income tax liability for 1937."

In the Tax Court's findings of fact, it was stated that the estate was entitled to "some part of one-half of that fee, —depending upon an allocation thereof between the period of joint interest and the period thereafter" (48), that "the executor had assumed that the estate's share would be very

* No exception is taken by petitioner to being chargeable with that portion of the estate's share, *when properly determined*, that may be properly allocated to the period of 6 months after death (61, 147).

much greater'' than the petitioner's estimate of $7,982 (50), and that from the beginning ''a real dispute existed between them with respect to the period of joint interest'', the estate contending for ''a period of approximately ten years'' and petititoner for ''only the eleven-month period from January 25, 1929, the date of the contingent fee agreement, to December 19, 1929, the end of the six-month period following the death of Burroughs'' (50). The executors were ''shocked'' at the smallness of the $7,982 check (92). The Tax Court, as did the Circuit Court of Appeals, held that the fee was not received under a claim of right (57, 148). After reciting the salient facts and observing that the court had before it ''evidence as to what the division of the fee turned out to be'' in a subsequent year (57), *the Tax Court held that since the court has ''that information at hand it would seem proper to use it in determining petitioner's income tax liability for 1937 rather than to make some kind of a theoretical allocation of the fee between the parties when it was received in 1937''* (57; see also 58). The Tax Court admitted its awareness of the rule that the issue was to determine the income as of the close of the taxable year ''without regard to the effect of subsequent events'' adding, however, ''but there are exceptions'' and concluding that ''there is precedent, we think, in the type of case we have here for *using the actual figures agreed upon by the parties early in 1938 rather than to make some kind of theoretical allocation at the end of 1937.** See *Lillie C. Pomeroy et al., Executors*, 24 B. T. A. 488; affd., 68 Fed. (2d) 411,'' (58), and, conceiving that the *Pomeroy* case was authority for ''*retroactive application of an agreement made by the parties*'' in a later year (59), applied the doctrine of that case as so conceived on the basis that ''*since we now know what*

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* Emphasis supplied as elsewhere herein, unless otherwise stated.

*the facts are as to the division of the fee in question * * * we shall tax petitioner in 1937 on the basis of the known facts as shown by agreement reached in the early part of 1938*" (59-60). It accordingly upheld the Commissioner in taxing petitioner with the entire fee, less the estate's share of $14,995, but failed to follow the Commissioner in the allocation of that fee as between the period of six months after the partner's death and the portion of the joint interest period prior thereto (60). The Commissioner having ignored all evidence relating to the situation as it existed in the year 1937, and having adopted the settlement figure of 1938 as the sole measure of petitioner's liability, the Tax Court held that he was obliged to accept the settlement in toto, including the agreed time of 50 months for the period of joint interest (which was a compromise figure adopted by the parties and was without support in the evidence) and allocated to the six months period after death 6/50 of the settlement figure, thus reducing the deficiency assessment from $25,774 to $21,564.

In summary, the Tax Court held (1) that the problem was to make an allocation as between petitioner and the estate with respect to the period of joint interest and the period thereafter (48), that under the evidence it was unable to make an allocation that would be more than theoretical (57; see also 58) and (3) that therefore it would ignore the provisions of Section 42 of the Internal Revenue Code requiring liquidation on an annual basis and give retroactive effect to the settlement made in 1938.

The Position of the Circuit Court of Appeals.

The Circuit Court of Appeals agreed substantially with the Tax Court as to the nature of the problem, saying that its solution "required a valuation of that part of the fee

which in 1937 legally (or equitably) belonged to the Burroughs estate" (149). Although the Tax Court held that it was unable to place a valuation on the estate's interest as of 1937, the Circuit Court of Appeals nevertheless held that the 1938 settlement figure which the Tax Court adopted in the place of such valuation was in fact a valuation of the estate's interest as of 1937 and this despite the Tax Court's disclaimer of the figure as being a valuation.

A subsidiary problem was also involved, namely, to apportion the estate's share between the period before death, with respect to which petitioner was not taxable, and the period after death, with respect to which he was taxable. The Commissioner, relying on the date of the fee contract (January, 1929) and taking 11 months as the period of joint interest, allocated 5/11ths of the $14,995 to the period prior to death and the remaining 6/11ths to the period after death (9). The Tax Court thought that, since the Commissioner went to the settlement agreement to ascertain the estate's share, he must also abide by the terms of that agreement for purposes of allocation. Since the arbitrarily agreed period of joint interest under the settlement agreement was 50 months and the period after death was 6 months, the Tax Court took the same basic figure of $14,995 and allocated 44/50ths thereof to the period before death and 6/50ths to the period after death (60). The Court below, continuing to indulge in the fiction that the $14,995 was an appraisal by the Tax Court of the 1937 value of the estate's claim despite the Tax Court's disavowal thereof as such, further held that the Tax Court in altering the Commissioner's allocation of the $14,995 as between the period before death and that after death, thereby "increased the valuation of that claim" (150). Of course, that holding is factually untrue. The words "that claim" referred to the item of $14,995. The change in allo-

cation of the item served neither to increase nor diminish or otherwise affect the item itself. The Court was given the opportunity to correct this error in the petition for rehearing (154) but with no response other than a summary denial of the petition.

Summary of Positions Below.

The Commissioner with all the facts before him arbitrarily discarded all evidence relative to the 1937 value and instead thereof resorted exclusively to the 1938 settlement figure of $14,995. On the allocation between the periods before and after death he ignored the settlement and adopted the 11-months period stemming from the fee agreement.

The Tax Court, having before it the same evidence as the Commissioner and more besides, found itself unable to make the allocation and, being fully aware of the annual liquidation requirement of the Internal Revenue Code (Section 42), considered that its inability to make the allocation as of 1937 required it to substitute the facts as of a later year and apply them *nunc pro tunc* to the year under consideration (58, 59). The Tax Court disavowed any notion that the $14,995 was a 1937 valuation of the estate's interest,—it frankly presented it as a substitute for a valuation (57, 58).

The Circuit Court of Appeals, stressing the burden resting on the petitioner in the Tax Court to show "error in the Commissioner's determination" (150) and in the Court of Appeals "of showing that the Tax Court's valuation is erroneous" (150), concluded that the Tax Court in "holding that the Commissioner had erred in part", thereby "increased the valuation of that claim" (150). The ultimate holding of the Circuit Court of Appeals was that

petitioner had not discharged the burden in the Court of Appeals, but had "merely argued that it was not easy to arrive at a precise valuation in 1937" (150).

The opinion below concedes, as must necessarily be so, that petitioner had carried the burden in the Tax Court of overcoming the deficiency assessment, since the Tax Court disapproved and reduced that assessment.

The holding of the Court below that petitioner had not carried the burden in that Court of showing error in the Tax Court's "valuation" is predicated upon two hypotheses, both of them false, namely, (1) that the item of $14,995 which the Tax Court utilized was in fact a "valuation" of the estate's claim as of 1937 even though the Tax Court itself disavowed the item as being a "valuation" and frankly admitted that it was resorted to because the Court was unable to make the valuation, and (2) that the action of the Tax Court in changing the Commissioner's allocation of the item as between the periods before and after death constituted an *increase* in that valuation. The insistence by the Court below that that was a valuation which the Tax Court, speaking of its own work, said was not a valuation, and its unwillingness on petition for rehearing to correct the patent error of holding that a reallocation of an item as between two periods constituted an increase in the "valuation" of that item, and its declining to pass upon the basic question whether the figures of a settlement agreement made in 1938 could be used to determine the 1937 value of a claim to the exclusion of all evidence having to do with the issue, viz., the true value as of the year 1937 (150), strongly suggest that the case has not had that full and unbiased consideration to which every litigant is entitled.

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

(1) In declining to determine whether the Tax Court had the right to adopt the figures of a settlement made in 1938 as the sole criterion to determine the 1937 value of the estate's claim and in not holding that it had no right to rely on said figures at all;

(2) In treating the figure of $14,995 as a "valuation" of the 1937 value of the estate's claim when the Tax Court had held that it was unable to make a valuation thereof and frankly adopted the item as a substitute for a legal valuation, which was based exclusively on illegal evidence, all legal evidence having been ignored;

(3) In holding that (a) the adoption by the Tax Court of the 1938 settlement figure constituted the placing of "a valuation" on the estate's 1937 interest in the fee, (b) that the action of the Tax Court in changing the Commissioner's allocation of that item as between the before death and the after death periods served to *increase* that "valuation" and (c) that petitioner failed to discharge the burden of showing error in that "valuation";

(4) In holding that the petitioner failed in respect of the burden of proof; when in fact after the assessment had been found erroneous, the burden was on the Commissioner, who failed;

(5) In following the Commissioner and the Tax Court in accepting the figures of the 1938 statement as sole criterion for the 1937 value of the estate's claim in that under

the *Dobson* case (...... U. S. ......, 88 L. Ed. 179; on rehearing, 459), the assessment must have "warrant in the record", and the assessment based exclusively on illegal evidence cannot have warrant in the record.

(6) In erroneously applying the law as laid down in the *Dobson* case, *supra,* in that when the Tax Court held that it was unable to make the allocation the alternative course was not to adopt a figure without "warrant in the record", but to deny the assessment because of the Commissioner's failure or inability to prove the correct figure, with the ultimate result that the item of income would belong to a later year.

Reasons for Granting the Writ.

(1) The exact rules governing burden of proof remain today in a state of confusion and this despite the clarification of that subject brought about by the decision in the *Dobson* case, and there still remains conflict in the decisions on that subject (*Taylor* vs. *Com'r,* 70 Fed. (2d) 619, aff'd 293 U. S. 507, 79 L. Ed. 623). If we correctly understand the *Dobson* case its effect here would be to hold that, the Commissioner's deficiency assessment having been upset by the Tax Court and that assessment having thereby been eliminated and the Tax Court having determined that it was unable on the evidence to ascertain the 1937 value of the estate's claim, the income involved must be carried over to another year because of the failure of the Commissioner to carry the burden of proof resting on him to show the correct amount.

(2) The decision, if allowed to stand, will add confusion to the administration of the law in that taxpayers similarly situated will be at a loss how to report their income, if it is

permissible to base a deficiency assessment on an agreement arrived at after the due date of his return, and on the basis of what occurred after the taxable year and after the filing date of the return (*Dobson* case).

(3) Because the Court below refused to follow the established rule of this Court, as for instance in the *Ithaca Trust* case (279 U. S. 151, at 154; 73 L. Ed. 647, at 649), that the facts as of the crucial date are the sole criterion and resort may not be had to later occurrences, and also because the Court incorrectly applied the rule of the *Dobson* case, and upheld the Tax Court in ignoring the requirement that all relevant factors be considered in making a valuation, as instanced by the *Ray Consolidated* case (268 U. S. 373, 69 L. Ed. 1003).

(4) Because the Court's theory that petitioner had failed to carry the burden of proof, which was a basic feature of its decision, was never presented to or argued either in the Court below or in the Tax Court (*Letulle* vs. *Scofield*, 308 U. S. 413, 84 L. Ed. 355; *Helvering* vs. *Gowran*, 302 U. S. 338). The petitioner never had an opportunity to meet this issue by evidence or by briefing or by oral argument, and was denied this opportunity even though request to that end was made in a petition for rehearing.

(5) Petitioner has never had his day in Court in that in spite of the fact that all possible evidence having a bearing on the issue has been presented by petitioner to the Commissioner, to the Tax Court and to the Court below, petitioner has been denied the privilege of a decision on the merits.

Wherefore your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this

Court directed to the United States Circuit Court of Appeals for the Second Circuit, sitting at New York, New York, commanding that Court to certify and to send to this Court, on a day certain to be therein named, a full and complete transcript of the record and all proceedings had in this case, entitled as above and numbered 189 on its docket for the October Term, 1943, to the end that this case may be reviewed and determined by this Court; that the said judgment of the United States Circuit Court of Appeals for the Second Circuit may be reversed by this Court; and that your petitioner may have such other and further relief in the premises as may seem just and proper.

And your petitioner will ever pray, etc.

H. Lewis Brown,
Petitioner,

H. Lewis Brown,
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Attorney for Petitioner.

June 2, 1944.

Brief in Support of Argument.

In General.

The basic problem is to determine what part of a fee of $228,064 collected by petitioner in October, 1937, for services rendered partly by a firm of two members and partly by himself as surviving partner, was *received to his own use* during the year 1937. The estate conceded that petitioner was entitled to at least one-half of the fee ($114,032) and petitioner conceded that the estate was entitled to at least $7,982 out of the other half. There thus remained for division between petitioner and the estate the balance of the fee, namely, $106,050.

This balance was received by petitioner and held by him for the benefit of himself and the estate. It was not received or held by him under a claim of right, so held by both courts (56-7, 148). The final problem, therefore, was to determine what part, if any, of said balance of $106,050 was received by petitioner *to his separate use* (*Eisner* vs. *Macomber*, 252 U. S. 189) during the year 1937. No part of this fund was used by him at any time during the year 1937 (48-51), nor at any time prior to March 10, 1938, when the estate for the first time made a statement of its claim in dollars with respect to the fund (50-51). Then petitioner and the estate set aside a joint fund, subject to joint checking only, equal to the amount claimed by the estate, namely $46,052, less the $7,982 theretofore paid to the estate, and kept this amount segregated until April 27, 1938, when an agreement was reached whereby the estate became entitled to receive and did receive an additional sum of $7,013, making a total of $14,995 (51). Petitioner's attitude towards the fund was that no part of that balance belonged to him or was received to his separate use until the happen-

ing of some event either fixing the amount to which the estate was entitled, or placing a ceiling on its demand. The latter occurred first, in the form of a letter addressed to petitioner under date of March 10, 1938, in which the estate claimed the sum of $46,052.

In the subsequent proceedings it became necessary to place a value on petitioner's interest *as of the year 1937* in the fund of $106,050. The Commissioner approached that problem (9) by charging petitioner with the entire

fee of	$228,064
less the agreed settlement figure of April 27, 1938	14,995
	213,069
plus portion of $14,995 allocated by him to the period before death	8,182
or a total, on account of the fee, of	$221,251

The assessment letter contained no explanation other than the Commissioner's claim that under Section 22a of the Revenue Code of 1936, the entire fee was taxable to petitioner "less . . . the amount ultimately paid to the Estate . . . under a former partnership agreement for the period prior to his death . . . " (9).

Since the problem was to determine the value of petitioner's interest in the fund as of the year 1937, the Commissioner's "obligation [was] to take into consideration every relevant fact" (*Ray Consolidated* vs. *U. S.*, 268 U. S., 373) and it was obviously error for the Commissioner to disregard all evidence as to the 1937 value and in lieu thereof to adopt a figure arrived at by a compromise agreement entered into in April, 1938 (*Ithaca Trust Co.* v. *United States*, 279 U. S. 151, at 155; 73 L. Ed. 647 and 650). The question there was to determine the value of a life estate in an estate tax case where a life tenant had survived for a

period of six months and the hearing occurred after that event. The Government, desiring to increase the tax, insisted on adherence to a valuation as of date of death on the basis of facts then existing. The estate, to diminish the tax, urged the use of the facts as known at the time of the hearing. Mr. Justice Holmes, speaking for the court, admitted that as a matter of "first impression" it would seem "absurd to resort to statistical probabilities when you know the facts," but added that "this is due to inaccurate thinking" (155, 650), and agreed that "the value of the thing to be taxed must be estimated as of the time when the act is done", and refused to yield to the temptation "to correct uncertain probabilities by the now certain facts".

The soundness of that decision has never been questioned. It has been frequently applied, notably in a recent decision of the Circuit Court of Appeals for the Second Circuit (*Guggenheim* v. *Helvering*, 117 Fed. (2d) 469 (CCA 2nd)), where the problem was to value an unlisted stock for estate tax purposes, and the question was the right to use the facts subsequent to date of death. The Circuit Court of Appeals held that this could not be done and after reviewing the facts, including the circumstance that unhappily for the estate death occurred at a time when prospects were bright, insisted on limiting the inquiry to the facts as of the date of death (472), and ruled thus: "What happened later has nothing to do with the case. *Ithaca Trust Co.* v. *United States*, 279 U. S. 151, 49 S. Ct. 291, 73 L. Ed. 647."

Since the Commissioner's assessment started out on a false foundation, upon that being shown the assessment was not entitled to the presumption of correctness. (*Clinton Cotton Mills* v. *Commissioner*, 78 Fed. (2d) 292; *Andrews* v. *Commissioner*, CCA 2, 135 Fed. (2d) 314, certiorari

denied Oct. 11, 1943, 80 L. Ed. 30). That point, however, is not of importance just here because whether the Commissioner's assessment was entitled to the presumption of correctness or not, it was upset and revised by the Tax Court and we do not need to consider any question of presumption or burden of proof in the Tax Court, since the carrying of the burden by the petitioner there has become a concessum through the Tax Court's disapproval of the assessment.

In the Tax Court

The problem was held there to turn upon "an allocation thereof [second half of fee] between the period of joint interest and the period thereafter" (48). The Tax Court had before it all of the voluminous evidence that was presented to the Commissioner, as shown by his assessment letter (8), as well as oral testimony and additional documentary evidence to enable it to make the allocation if it could be done. The Court had before it petitioner's own estimate, made *ex parte* and before any discussion with the executor, that the estate's interest amounted to $7,982 (126). It also had before it the fact that this estimate was predicated on 11 months as the period of joint interest (based on date of fee contract, January, 1929, as the starting point), and that the executor though only partially informed was *shocked* (92) at the smallness of the petitioner's estimate, and that the estate claimed 10 years as the period of joint interest, insisting that the inception of the litigation (1920) was the starting point (95, 96). It also had evidence before it that the entire period involved from whatever standpoint, —beginning in 1920 from the estate's standpoint, in January, 1929, from petitioner's standpoint and ending in

December, 1929, from both viewpoints,—was a period of continuous though not perhaps uniform activity (126, 131, 132).

With all this information before it and with a full appreciation that its problem was to make "an allocation thereof between the period of joint interest and the period thereafter" (48), the Tax Court held that it was unable to make a legally sound allocation.* Since the Tax Court correctly understood its problem and since all the evidence available for the allocation was fully presented to the Tax Court and that court held that it was unable to make the allocation, then under familiar principles of tax law it must be held that the receipt by petitioner in 1937 of the undistributed fund of $106,050, received and held by him not under claim of right but for the benefit of himself and the estate, did not involve receipt of income *to his separate use* in 1937, because the burden was on the Commissioner in the first instance to segregate an identifiable portion thereof in a lawful way as having been received by petitioner to his separate use in 1937, and in this the Commissioner failed in the first instance by using

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* It preferred to use the legally unsound figure of $14,995, "in determining petitioner's income tax liability for 1937 rather than make some kind of a theoretical allocation of the fees between the parties when it was received in 1937 . . ." (57). It also thought that the *Pomeroy* case, 68 Fed. (2d) 411, was "precedent . . . for using the actual figures agreed upon by the parties early in 1938 rather than to make some kind of a theoretical allocation at the end of 1937" (58), at the same time stating that it was "well aware that the general principles of Federal income taxation required the determination of income at the close of taxable years without regard to the effect of subsequent events" (58), and so, as stated in the official headnote, gave effect, retroactive to 1937, to the April 27, 1938, agreement (43, 59). While the Tax Court correctly reported what happened in the *Pomeroy* case, it omitted to state that the Commissioner's use of a post year settlement in that case was not challenged in the Tax Court or in the Court of Appeals, but the question was raised for the first time in petition for certiorari. The *Pomeroy* case was not urged as a precedent in the Court below.

an illegal basis for his determination, thereby destroying the presumption of correctness and leaving the case wholly to the evidence with the burden of proof on him, (*Andrews* vs. *Com'r,* 135 Fed. (2d), 314, certiorari denied 88 L. Ed. 30; *U. S.* vs. *True,* 51 F. S., 720, at 725; *San Joaquin Brick Co.* vs. *Com'r,* 130 Fed. (2d) 220, at 225; *Hemphill Schools* vs. *Com'r,* 137 Fed. (2d) 961, at 964; *New York Life* vs. *Gamer,* 303 U. S. 101, 88 L. Ed. 727), failed later on, in the Tax Court, in that the latter upset his determination and in addition held that the facts did not admit of a legal determination as of the year 1937.

The case is similar to the long line of cases involving receipt of income in the form of property having no market value, a prominent instance of which is *Helvering* v. *Tex-Penn Oil Co.,* 300 U. S. 481, 81 L. Ed. 755, where this court, after observing that the shares of stock under consideration were hedged about by so many restrictive agreements as not to have "a fair market value, capable of being ascertained with reasonable certainty when they were acquired by the taxpayers", held (499, 767) that "in the absence of such value the ownership of the shares did not lay the basis for the computation of a gain at the time they were received or for a tax as of that date under the applicable statute".

Such a determination is in the category of a finding of fact, and of course as such is not subject to review (*Elmhurst* v. *Commissioner,* 300 U. S. 371, 81 L. Ed. 491; *U. S.* v. *State Street Co.,* CCA 1, 124 Fed. (2d) 948 at 950).

Here again that respect for the decisions of the Tax Court which has been enjoined upon the appellate courts by the decision of this Court in *Dobson* v. *Commissioner* (U. S. , 88 L. Ed. 179) requires that the determination of the Tax Court that it was unable to make an allocation should not have been disturbed by the Court below.

When the Tax Court reached the conclusion that it was unable to make the allocation, it should have applied the principles of the *Tex-Penn Oil Co.* case and held that receipt of the fund by petitioner for himself and the estate in 1937 gave rise to no taxable income as of that year with respect thereto. But this the Tax Court did not do; instead it felt obligated to ignore the year end liquidation mandate of the Internal Revenue Code (Section 42) and utilized a figure that has no relevancy.

What the Court below should have done was to follow the Tax Court in its holding that it was unable to make the allocation and then, applying the principles of the *Tex-Penn Oil Co.* case, have held that the petitioner's unascertained interest in the item of $106,050 gave rise to no taxable income in the year 1937.

Assuming that the Tax Court was correct in its conclusion of inability to make the allocation, as we must assume under the decision in the *Dobson* case and other cases cited immediately above, the Court below should have abided by that determination of the Tax Court, but should not have followed it in the error of adopting a basis without "warrant in the record", namely, the settlement figure of April, 1938. The Court below should have corrected that error of the Tax Court and, following the *Tex-Penn Oil* case, have set aside the assessment *in toto*.

Burden of Proof.

If the view here urged be accepted and as a result the Court below be reversed with instructions that by appropriate proceedings the Commissioner's assessment be set aside *in toto*, then no question of burden of proof arises.

On the other hand it may be urged that, even though the Tax Court approved the arbitrary assessment figure ad-

vanced by the Commissioner, and even though it found itself unable to place a valuation on petitioner's interest, the burden would be on the petitioner to show that even this arbitrary figure was not excessive. Should that view prevail, then the question of burden of proof becomes important.

Petitioner prevailed in the Tax Court to the extent of securing a substantial reduction in the deficiency assessment; hence there can be no question that he sustained whatever burden rested on him in that court.

In the Court of Appeals petitioner showed that the so called valuation by the Tax Court was a figure without "warrant in the record". Among other infirmities it was based on a settlement figure arrived at through compromise four months after the end of the taxable year; the settlement itself was predicated on a joint interest period of fifty months, which was arbitrarily adopted for compromise purposes and was wholly unrelated to any fact in the record; the Commissioner treated that figure, contrary to the fact, as being predicated on a joint interest period of eleven months and the Tax Court changed that factor to fifty months without changing the "valuation" by one penny,—and in view of all these circumstances and of the fact that the Tax Court itself disclaimed the figure as being a *valuation*, it is purely fiction to characterize the figure as a valuation. Hence, petitioner in the Tax Court certainly carried the burden of showing that the figure used by the Tax Court as a substitute for a valuation was purely arbitrary, and it did not devolve upon petitioner at that stage to go further and show that the substitute was in excess of what a proper valuation would have been. At this point we refer to the able discussion of the subject by the Court below in *Taylor* v. *Commissioner* (70 Fed. (2d) 619, at 620, 621,

affirmed by this Court, 293 U. S. 507), also to *U. S.* v. *True*, 51 F. S. 720, and other cases cited therewith, *supra*, page 19. But, if that burden did rest on petitioner, the evidence shows conclusively that the figure of $14,995 imported into the case from the extraneous area of a subsequent year did serve to impose a higher tax on petitioner than would have been the case had the Tax Court utilized the evidence of value as of 1937 and had felt able therewith to carry through to a valuation.

The facts are that as of the end of the year 1937, petitioner had in his hands a joint interest fund of $106,050. If he was right in the preliminary view expressed by him in October, 1937, which was predicated on a joint interest period of 11 months, then the whole fund belonged to him. On the other hand, throughout 1937 the estate insisted that the period of joint interest was ten years, and if its position on that point had prevailed and other factors had not interfered, the estate, with its period of ten years for joint interest, would have been entitled to approximately one-half of the fund of $106,050. Under the settlement agreement the petitioner retained as his own $99,037 out of the fund, and the estate received the remaining $7,013.

If petitioner had undertaken at any time in 1937 to sell his interest in the fee for cash is it conceivable that he could have found a purchaser willing to pay anywhere near the sum of $99,000 for such interest when there was hanging over that interest a claim of the estate, made in good faith and presented on the advice of able counsel, that might cut the $106,050 down to less than $60,000? That method of arriving at a value of something that lacks established market value has recently had the approval of the Circuit Court of Appeals for the Second Circuit in *Andrews* v. *Commissioner*, 135 Fed. (2d) 314, certiorari denied October

11, 1943, ... U. S. .... 88 L. Ed. 30. The question there was to value script that had no readily realizable market value, and the Circuit Court of Appeals held that in such a case a legal test was "what you could have got for it in money if you could have sold it" (307), but that where the figure relied on by the Commissioner was only a "guess", and that guess not supported by the evidence, "the Commissioner then had the burden of adducing evidence to sustain his assessment" (319). Moreover, in such a situation, the existence of such a cloud on petitioner's interest as the estate's claim of ten years for the period of joint interest, which would have served to cut his interest approximately in half, as against petitioner's claim of eleven months for the period of joint interest, has been very properly held to be an appropriate consideration in making evaluations (*Champlin Refining Co.* v. *Commissioner*, C. C. A. 10, 123 Fed. (2d) 202, where it was conceded that the value "free from title hazard was [worth] $1,530,000" and because of the litigation the Board held "that the clouded lease had a value of $1,147,500").

While, of course, it was not the function of the Circuit Court of Appeals to find a value, that being the sole function of the Tax Court, it is obvious from a perusal of the record that, if the Tax Court on the basis of the evidence before it, instead of finding that it was unable to arrive at a valuation, which appears to us to be an entirely sound holding, had undertaken to place a value on petitioner's interest in the fund on the basis of "what you could have got for it if you could have sold it", it would have been obligated to find that the realizable value of petitioner's interest in a fund of $106,050 at any time in 1937, would have fallen far below the $99,000 figure allowed in the settlement agreement; for the estate was in good faith and on the advice of able counsel asserting a claim founded on

a basis that, if sustained, would have cut petitioner's interest well below $60,000.

Also the Court below has, in a very able opinion delivered by Judge Learned Hand, indicated that consideration of market value and of what a purchaser would have given for petitioner's interest in such a situation largely revolves around considerations of unrealities, since it is obvious that there is no real market for such an item (*Helvering* v. *Walbridge*, 70 Fed. (2d) 683).

It is believed, and we respectfully urge, that the court below erred (1) in treating the settlement figure of $14,995 as a valuation by the Tax Court when the Tax Court held that it was unable to make a valuation and that the figure itself adopted from an extraneous field was a court-made substitute for the valuation required by statute; (2) in holding that petitioner failed to carry the burden in the court below of showing error in the Tax Court's figure, since petitioner showed that the figure itself was established on a false basis and petitioner, though not showing the correct amount, which was the Commissioner's obligation, showed that the amount chargeable to him on any correct theory was vastly less than was done by the Commissioner or the Tax Court or the court below. The court also erred in saying that the action of the Tax Court in changing the allocation of the so-called valuation of $14,995 as between the periods before and after death thereby "increased the valuation of that claim" (150). That holding is predicated on a complete misreading of the record and has been obstinately adhered to by the court below in the face of an opportunity for correction presented by petition for rehearing. It appears to have been inserted to boost the fiction that the figure itself was a valuation.

The problem before the Court, as recognized by the Tax Court and the court below, was to ascertain what part of the item of $106,050 received by petitioner in 1937 for the benefit of himself and the estate was received by him for his separate use in that year. The whole history of the transaction extending over a period of years is spread upon the record and all the evidence of which the case admits was before both Courts. The Tax Court held that, despite this evidence, it could not make an allocation as of 1937 that would segregate any designated part to petitioner as having been received to his separate use. It was particularly the duty of the Commissioner and of the courts to discard all considerations showing value as of a date subsequent to 1937 (*Ithaca Trust* case, 279 U. S. 151 at 154, 155; 73 L. Ed. 647 at 649, 650; *Guggenheim* v. *Helvering*, 117 Fed. (2d) 469). Nonetheless, the Commissioner refused to consider any of the facts pertinent to the 1937 value, as it was his duty to do under the decision of Justice Brandeis quoted above (*Ray-Consolidated*, 268 U. S. 373) and based his decision solely on grounds forbidden to him by the *Ithaca Trust* case. The Tax Court, having given full heed and consideration to the relevant facts and found that they were an insufficient basis on which to evaluate petitioner's interest as of 1937, concluded that, therefore, it must go, and it did go, to the grounds forbidden by the *Ithaca Trust* case. The court below in complete disregard of realities held that the Tax Court's use of a figure founded on a false basis was a *valuation*, which is only a fiction in view of the fact that the Tax Court itself said it was not a valuation, and held that petitioner had not shown error and, most illogical of all, insisted that the Tax Court "increased the valuation of that claim" by realigning the allocation of the item as between two periods.

It is accordingly submitted that the present case involves important questions of conflict respecting burden of proof, as to which much clarification is needed, as well as questions the solution of which is important to taxpayers to enable them to correctly make out their returns; that it ignores the decisions of this Court in the *Ithaca Trust* case (279 U. S. 191), in the *Dobson* case (88 L. Ed. 179), and the *Ray Consolidated* case (268 U. S. 373), and because the issue of burden of proof, which was the foundation stone of the decision below, was never presented or discussed by either side in the court below or in the Tax Court and the opportunity therefor was denied to petitioner, though specifically prayed for on an application for rehearing, and that the case was decided incorrectly below and that the petition should be granted.

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June 2, 1944.

No. 128

In the Supreme Court of the United States

OCTOBER TERM, 1944

H. LEWIS BROWN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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Commissioner of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 43–61) are reported in 1 T. C. 760. The opinion of the Circuit Court of Appeals (R. 145–150) is reported in 141 F. 2d 307.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 7, 1944 (R. 161). A petition for rehearing was denied on March 6, 1944 (R. 160). The petition for a writ of certiorari was filed on June 5, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

What portion of a fee of $228,608.44 for legal services should be taxed as income of the taxpayer in the calendar year 1937?

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.
>
> The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

STATEMENT

The facts found by the Tax Court (R. 45–53) may be summarized as follows:

The taxpayer, a citizen and resident of New York City, kept his books of account and made his federal income tax return for the year 1937 on the basis of cash receipts and disbursements (R. 45).

On July 2, 1923, the taxpayer, who is a lawyer, and Ambrose H. Burroughs became associated as partners in the practice of law in New York City under the firm name of Burroughs & Brown. Under their agreement, the partners agreed to share equally in the income and expenses of the firm. The agreement also provided that the death of either should not effect a dissolution of the partnership, which was to be continued for six months thereafter, and the estate of such deceased partner should share in the income and expenses of the firm to the same extent that he would have done if he had lived. In case of the dissolution of the firm by the death of one of the partners, the survivor could continue the practice alone or in conjunction with others under the firm name of Burroughs & Brown. (R. 45.)

The original agreement was supplemented on March 19, 1929, by adding the following thereto (R. 46):

> As to work being done by the firm at the time of dissolution, whether pursuant to notice or six months after the death of one of the partners as provided in the contract, the fees and compensation for such work when and as collected shall be apportioned as follows: (1) to the firm such part thereof as will fairly represent the value of the

> service rendered during the existence of the firm, having in view the amount and character of such service as compared with the entire service; and (2) the rest to the partner completing the service after dissolution, or if both partners participate in the work after dissolution, then to each of them in proportion to the fair value of the service rendered by them respectively. This method of division shall be applicable whether the compensation be on a contingent basis or otherwise.

At the time of the formation of the partnership, the members were representing the plaintiff in a patent infringement suit pending in the United States District Court for the District of New Jersey. The decision of the District Court in that case, *Southern Electro-Chem. Co.* v. *E. I. Du Pont de Nemours & Co.,* 9 F. 2d 69, rendered on August 14, 1925, in favor of the defendant was reversed by the Circuit Court of Appeals for the Third Circuit on March 1, 1927 (20 F. 2d 97, rehearing denied May 27, 1927). Under that decision, the Southern Electro-Chemical Company, the client of Burroughs & Brown, became entitled to an accounting for profits and damages growing out of the patent infringement. During the period 1925 to 1929, the firm of Burroughs & Brown received a retainer from the Southern Electro-Chemical Company, principally for services in the litigation and in supervising and giving ad-

vice regarding the company's general affairs. (R. 46–47.)

On January 25, 1929, the firm of Burroughs & Brown entered into a fee agreement under which the firm became entitled to a contingent interest in the ultimate recovery from the litigation. This agreement was with the Alper Chemical Corporation, whose interest in the matter arose from an agreement between it and the Southern Electro-Chemical Company with respect to the conduct of the litigation. (R. 47.) The agreement (R. 47–48) is in the form of a letter addressed to the Alper Chemical Corporation by the firm of Burroughs & Brown, stating that they would take actual charge of the accounting about to commence in the case of *Southern Electro-Chem. Co.* v. *E. I. Du Pont de Nemours & Co., supra,* at the rate of $10,000 per year, and in addition a percentage of any amounts paid by the defendant for infringement.

Burroughs died June 19, 1929, and the City Bank Farmers Trust Company qualified as executor of his estate. Since the death of his partner, with the exception of an eight-month period not here material, the taxpayer has continued the practice of law as sole proprietor under the firm name of Burroughs & Brown. (R. 48.)

As surviving partner, the taxpayer continued the accounting in the patent infringement litigation until September 21, 1937, when a final settle-

ment was reached. The compensation owing under the terms of the contingent fee agreement of January 25, 1929, amounted to $228,068.44. On October 22, 1937, the Southern Electro-Chemical Company delivered to the taxpayer its check for that amount payable to the order of Burroughs & Brown. Under the partnership agreement, the Burroughs estate thereupon became entitled to participation in some part of one-half of that fee, depending upon an allocation thereof between the period of joint interest and the period thereafter. (R. 48.)

Upon receipt of the check for $228,068.44, the taxpayer deposited it in an account with the Chase National Bank which he maintained under the name of Burroughs & Brown and used exclusively for the law office that he was conducting as an individual under that style. Moneys received by him which belonged to others were also deposited in that account. Generally, the monthly balance was never more than $5,000. In addition to the taxpayer, his wife and Clyde D. Sandgren, an employee, each had authority to draw against that account. From October 22, 1937, until December 31, 1937, the lowest balance in the Burroughs & Brown account was $117,-930.41. The taxpayer maintained such a high balance during that period because he and the executor of the Burroughs estate had not yet agreed upon the estate's share of the fee. (R. 48–49.)

On October 28, 1937, the taxpayer forwarded to the executor of the Burroughs estate a check drawn on his Burroughs & Brown account in the sum of $7,982.40. The check was accompanied by a letter in which the taxpayer stated his views concerning a division of the fee under which the estate was entitled to three and one-half percent of the total fee paid. (R. 49–50.)

At the time of the receipt of the taxpayer's check for $7,982.40 and his letter of October 28, 1937, the executor had assumed that the estate's share would be very much greater. The check tendered by the taxpayer was received and cashed without prejudice. The taxpayer computed the three and one-half percent of the total fee on a period of joint interest covering the eleven-month period from January 25, 1929, the date of the contingent fee agreement, to December 19, 1929, the end of the six-month period following the death of Burroughs. The executor contended that the fee represented compensation for the whole period of the infringement litigation and that therefore the period of joint interest extended from the inception of the litigation in 1920 until December 19, 1929, or a period of approximately ten years. (R. 50.)

By letter dated March 10, 1938, the executor claimed that the Burroughs estate was entitled to the total sum of $46,052.25 on account of the fee. The difference between the amount claimed

by the estate and the amount previously paid to the estate on October 28, 1937, was withdrawn from the joint bank account of the taxpayer and his wife on March 14, 1938, and deposited in a joint account between the taxpayer and the executor to await a final division after agreement of the parties. (R. 50–51.)

On April 27, 1938, it was agreed that the Burroughs estate was entitled to $14,995.50 on account of the fee based on a joint interest extending from October 15, 1925, to December 19, 1929, a period of approximately 50 months (R. 51).

In his federal income tax return for the calendar year 1937, the taxpayer included as income on account of the fee the sum of $182,016.19, being the full amount of the fee, $228,068.44, less the sum of $46,052.25, the amount first claimed on March 10, 1938, by the Burroughs estate as its share of the fee (R. 52).

The Commissioner treated the total period of joint interest as extending from January 25, 1929, to December 19, 1929, a period of approximately eleven months. On a time basis, he determined that five-elevenths of $14,995.50 was applicable to services rendered prior to the death of Burroughs, and six-elevenths was applicable to services rendered during the period of six months immediately after his death. (R. 51–52.) He included in the taxpayer's income for the calendar year 1937, $221,252.29, being the entire

fee of $228,068.44 less the sum of $6,816.15 allocated by him to the period of joint interest prior to Burrough's death (R. 52).

On February 26, 1940, the taxpayer filed a claim for the refund of $43,450.48 of the taxes paid on the ground that in 1937 the taxpayer was taxable on only one-half of the total fee to which he was unqualifiedly entitled in that year and that he held the other half as trustee for the estate of Burroughs (R. 52–53).

The Tax Court held that, based upon a period of joint interest of 50 months, $13,196.04 of the $14,995.50 actually paid to the Burroughs estate should be allocated to the period of joint interest prior to Burroughs' death, that six-fiftieths or $1,799.46 should be allocated to the period of joint interest after Burroughs' death and that $214,872.40 ($228,068.44 less $13,196.04) was income of the taxpayer in 1937 (R. 60). It was agreed by both parties that the amount of the fee which was paid the estate for the six-month period after Burroughs' death was a capital payment in part for Burroughs' interest in the partnership and was taxable as income of the taxpayer (R. 61). The Circuit Court of Appeals affirmed (R. 145).

ARGUMENT

There is no conflict of decisions and none is pointed out by the taxpayer. Nor is the question one of general interest or of broad application in the administration of the tax laws.

The taxpayer's contention (Pet. 12 (1)) that the Commissioner's determination was upset by the Tax Court is without merit. The opinion of the Tax Court upheld the basic figure of $14,-995.50, which the taxpayer agreed with the executor was the estate's share of the total fee, and which was used by the Commissioner in determining the estate's share of the total fee (R. 60). The only change made by the Tax Court was in accord with the taxpayer's alternate contention that the portion payable to the estate as capital, and agreed to be taxable as income to the taxpayer, should be based on a 50-month period of joint interest instead of the 11-month period used by the Commissioner (R. 61).

The decisions below have reached the correct result. The taxpayer filed his income tax returns on the cash basis and in the taxable year 1937 received a total fee of $228,068.44, part of which, under the partnership agreement, was payable to the estate of his deceased partner. In October 1937, he computed the share of the estate at $7,982.40 and sent the estate a check in payment, which was cashed without prejudice as to any further rights of the estate to a larger share. Early in 1938, the estate claimed $46,052.25 *in toto* and in April 1938, the matter was settled on the basis of $14,995.50 as the estate's share of the fee.

The taxpayer claims that his taxable income from the fee in 1937 was $106,050[1] (Pet. 3), representing one-half of the total fee received, less the payment made to the estate in 1937. As the Tax Court and the Circuit Court of Appeals pointed out, there is no sound basis for such a contention. The taxpayer testified (R. 85) that he never expected to pay the estate half of the fee. The estate never claimed half of the fee as its share, and the trust officer testified (R. 95) that he did not expect to get the $46,000 claimed, but only $15,000 or perhaps $12,000. There never was a basis upon which the estate could have claimed half of the fee. Nor did the taxpayer hold half of the fee as trustee for the estate. He recognized no trust and the law did not impose upon him the strict obligations of a trustee. He was not a trustee for tax purposes even if he had been "so denominated" by state law (*Heiner* v. *Mellon*, 304 U. S. 271, 279).[2]

This Court has said that "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed" (*Corliss* v. *Bowers*, 281 U. S. 376, 378; see also *Griffiths* v. *Commissioner*, 308 U. S. 355,

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[1] The exact figure is $106,051.82.

[2] Under New York law, the taxpayer was not a trustee. (*Gilmore* v. *Ham*, 142 N. Y. 1, 7, 10). The surviving partner does not take over firm assets as a trustee (*Costello* v. *Costello*, 209 N. Y. 252, 259; *Preston* v. *Fitch*, 137 N. Y. 41, 56–57; *Williams* v. *Whedon*, 109 N. Y. 333, 338; *Wilson* v. *International Bank*, 125 App. Div. (N. Y.) 568, 572).

357). In 1937, the taxpayer had full control over the total fee. He deposited the whole fee in the bank account of Burroughs and Brown (R. 77), which was also subject to check by the taxpayer and his wife (R. 83). On October 29, 1937, he withdrew $100,000 from that account (R. 99) and on January 25, 1938, $115,000 was transferred to the personal joint account of taxpayer and his wife (R. 78, 84, 102), leaving a balance in the Burroughs and Brown account of only $3,766.38 (R. 101). It was not until March 14, 1938, that $38,069.85 was withdrawn from the joint bank account of the taxpayer and his wife and deposited in a joint account of the taxpayer and the executor of the estate (R. 51). Throughout all of the year 1937, the funds were under the control of the taxpayer, who claimed all of the total fee, less the $7,982.40 which he admitted was due the estate. See *North American Oil* v. *Burnet*, 286 U. S. 417.

Since the taxpayer was on the cash basis and received the total fee in 1937, his share of the fee, under settled principles of accounting, was taxable to him in 1937, the year of receipt, and in no other year. No part of his share may be taxed as received in the year 1938. The Tax Court has taken the fact established in 1938 by the settlement effected with the estate and thereby determined the taxpayer's share of the fee taxable to him in 1937. It has reached the correct result

to the exact penny. The taxpayer's contention that it should have valued his interest in the fee as of the end of 1937 and ignored subsequent fact to indulge in speculation is without merit. The relation back in the instant case was resorted to only as a means of determining the exact amount of the taxpayer's share of the fee, which was received and had been fully earned in 1937. The result is to tax his share in the year in which he received it, and this result accords with the requirement of the statute that the income be taxed in the year of receipt.

Moreover, there is ample precedent for the Tax Court's determination. In *Freuler* v. *Helvering,* 291 U. S. 35, 38–39, the accounting of a trustee approved in 1928 was held determinative of the taxable income of trust beneficiaries for the year 1921. And the taxable share of a surviving partner was determined by subsequent events in *Pomeroy* v. *Commissioner,* 24 B. T. A. 488, affirmed, 68 F. 2d 411 (App. D. C.), certiorari denied, 292 U. S. 635. Cf. *DeBrabant* v. *Commissioner,* 90 F. 2d 433 (C. C. A. 2d); *Mott* v. *Commissioner,* 139 F. 2d 317, 318 (C. C. A. 6th).

Ithaca Trust Co. v. *United States,* 279 U. S. 151; *Guggenheim* v. *Helvering,* 117 F. 2d 469 (C. C. A. 2d); and *Ray Copper Co.* v. *United States,* 268 U. S. 373, relied upon by the taxpayer (Pet. 16–17), do not control the issue here. The first two cases involved valuation of interests

as of the date of decedent's death as required by the statute for estate tax purposes, and the last case involved the basis (market value of the shares of stock, or the value of corporate assets) of valuing corporate stock for capital stock tax purposes. In such cases, there must be a valuation. The taxpayer's position confuses valuation of an interest for such purposes as distinguished from the determination of the amount of taxable income received in a given year.

The taxpayer contends (Pet. 19–22) that the burden of proof was on the Commissioner to determine the taxpayer's interest in the fee at the end of 1937 and to make an allocation of income between the years 1937 and 1938. The Commissioner determined the income taxable to the taxpayer in 1937 based upon the total fee received, less disbursements made to the estate. He used a period of 11 months' joint interest in adjusting the capital item (R. 53). The Tax Court modified that determination by using a period of 50 months' joint interest according to the agreement of settlement (R. 60–61). Thus, the fundamentals of the Commissioner's determination were sustained, and there was no further burden of proof upon the Commissioner (*Helvering* v. *Gowran*, 302 U. S. 238, 245). The Circuit Court of Appeals said the taxpayer did not meet the necessary burden of proof by showing that the Tax Court's valuation was erroneous merely by arguing that

a precise valuation in 1937 was difficult (R. 150).

The taxpayer asserts (Pet. 12) that the assessment "based exclusively on illegal evidence cannot have warrant in the record." There is no support for such a statement as all of the evidence was presented by the taxpayer (R. 76–113) or was stipulated (R. 114–140).

If the decision in *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231, is applicable, it supports the Government's position rather than that of the taxpayer. Cf. *Dixie Pine Co.* v. *Commissioner,* 320 U. S. 516.

CONCLUSION

The decisions below are obviously correct and there is no warrant for further review by this Court. The petition should be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 128.

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REPLY BRIEF FOR PETITIONER.

General.

Respondent's brief is conspicuous for its omission of two basic elements. It fails to state what the problem before the Court was and it does not even allude to the fact that the Tax Court found itself unable to solve the problem, except on a purely arbitrary or theoretical basis (R. 57, 58).

The problem, as understood by the Tax Court, involved "an allocation thereof [the fee in question] between the period of joint interest and the period thereafter" (R. 48). A similar conception on the part of the Court below was that a resolution of the issue "required a valuation of that part of the fee which in 1937 . . . belonged to the Burroughs estate", and that "since all the pertinent facts needed for that purpose were fully available in 1937, no occasion existed for postponing that valuation until a later year"

(R. 149); *in other words, the problem was to value petitioner's interest on the basis of the pertinent facts, all of which occurred during 1937.*

Both courts below were aware of the necessity of placing a valuation on petitioner's interest in the fee when received. The Court below stated that "the sole issue here is whether the Tax Court erroneously determined the 1937 value of the estate's claim" (R. 150).

All pertinent evidence was adduced. The Tax Court held that from this pertinent evidence it could do no more than "to make some kind of a theoretical allocation" in the premises (R. 57, 58), and hence resorted to a settlement of a later year, not as a valuation, but, with considerable apology, as a judge-made substitute for a valuation.

These basic elements are absent from Commissioner's brief and argument.

Reasons for Granting the Writ.

On this point it is urged that petitioner has shown no reason for granting the writ, particularly on the angle of conflict. Petitioner cited *Taylor* v. *Commissioner,* 70 F. (2d), 619 at 621, where Judge Learned Hand fully develops the fact that there is conflict on this matter and to a similar discussion of that subject by this Court in the same case (293 U. S. 507, 79 L. Ed. 623). The conflict extends even to what is required to upset the presumption, which is the foundation stone on which the Commissioner rests. Some Courts hold that when evidence is produced "as to the process by which the commissioner arrived at his determination" and this process is illegal, as is obviously true here, "the presumption ceased, and thenceforth the issue depended 'wholly upon the evidence'." (*True* v. *U. S.,* 51 F. Supp. 720 at 725, citing among other cases *Hemphill*

Schools v. *Commissioner,* 137 F. (2d) 961. See also *New York Life* v. *Gamer,* 303 U. S. 161, 82 L. Ed. 726.)

In the instant case the Court below held that the Tax Court's figure, based on a compromise settlement made in a post tax year, was a "valuation" and that, therefore, the Court "need not consider whether the Tax Court, in arriving at its conclusion, properly relied upon the settlement made in 1938" (R. 150). That view is directly in conflict with a decision of the Sixth Circuit handed down April 12, 1944 (*Cornett-Lewis Coal Co.* v. *Commissioner,* 141 F. (2d) 1001), where it was held that the Commissioner's determination must be "from some competent evidence", that "the imposition of a tax cannot rest purely on a statutory presumption if such presumption is inconsistent with the facts", and that when "such [contrary] evidence appears the presumption ends" (1004). The Circuit Court of Appeals for the Sixth Circuit also in that case openly disapproved the views of the Second Circuit on this issue as reflected in *Regensburg* v. *Helvering,* 130 F. (2d) 507, and ruled that before the Commissioner may assess a deficiency, he "must find facts supporting the assessment" and that the "taxpayer is entitled to know the basis of law and facts" on which the assessment is made and "until this is done, there is no burden of proof resting on the taxpayer".

The Court below certainly put the cart before the horse in saying that it was unnecessary to consider the legality of the basis.

It is suggested that not only must illegality of basis be shown but error in amount as well. Respondent asserts over and over again that the result is right because it reflects the amount of petitioner's share in the fee to the exact penny, not the 1937 value of his interest, but the amount for which it was liquidated in 1938. That assertion assumes

that the problem was to find out what petitioner ultimately realized. The Tax Court and the Court below, as the statute obliged them to do, conceived the problem to be to ascertain the 1937 value of petitioner's interest, that is, what was the value in 1937 of petitioner's interest in the fund of $106,051 then in his hands. The answer to that question required a weighing of the evidence, that is, all of the evidence bearing on that point in 1937 (*Ray Consolidated* v. *U. S.*, 268 U. S. 373; *N. Y. Life* v. *Gamer*, 303 U. S. 161).

The Tax Court having reached the conclusion on the evidence that it could not find the answer otherwise than on a purely theoretical basis, we believe that the principle of the *Dobson* case requires a holding that the Commissioner failed to carry the burden of proof. Petitioner ultimately received approximately $99,000 in April 1938 out of the fund of $106,051, and the Commissioner assessed him on that basis as if that was the value in 1937. What does value as of a given date mean? Does it mean the ultimate realization as of some later known date? Or does it mean what could be realized on a liquidation of the item as of the time in question? Certainly it does not mean the former. Conceivably it might well mean the latter (*Cf. Andrews* v. *Commissioner*, 135 F. (2d) 314, certiorari denied). If it means the latter, that is, realizable value in 1937, then no one will suggest that petitioner could have realized anywhere near $99,000 on his interest in that claim at any time in 1937. The estate had not fixed a dollar value on its interest but had insistently urged that it was entitled to participate on the basis of a ten-year period of joint interest. That view, if sustained, would have meant that petitioner's interest was worth not $99,000, but something less than $60,000. The taxpayer does not have to measure the depressing effect in dollars of the estate's position, but if considerations of that character apparent in the record

show the assessment is too high, the appellate court will be governed accordingly and will not require the taxpayer to show the correct figure (*Taylor* v. *Commissioner*, 70 F. (2d) 619, 293 U. S. 507).

Respondent denies that the question involved is one of general interest or of broad application in the administration of the tax laws. Of course, it is of great interest to the Commissioner that the decision should stand, for it gives him an unconscionable advantage over the taxpayer in all similar situations. By it he is allowed through retrospect to hold the taxpayer to the duty of doing the impossible, viz., to report the future. But the Commissioner is not the sole party in interest and an honest taxpayer is entitled to honest treatment just as much as an honest Commissioner. The consideration of public interest extends to the taxpayer as well as to his servant the Government.

On the same issue of reasons for the writ nothing is said about the fact that the point on which the case was decided, namely, burden of proof, was never once raised in the Tax Court or in the court below by either party, in oral or written argument, but was an issue created by the decision of the court below, which denied the opportunity for argument that a rehearing would have afforded. Inevitably the taxpayer thus treated feels the sting of a sense of injustice and it is an important function of the courts to avoid the creation of such a feeling, if reasonably founded.

Much is said of circumstances such as that petitioner had control of the fund, that he didn't expect to pay the estate one-half of the fee, and similar circumstances. But all these are beside the point. They could have relevancy only as to whether or not the fund was received under a claim of right and only for that purpose. But both courts below held that claim of right was not an element in the case. The Court of Appeals said, "As the entire fee did not

belong to Brown, and as he does not claim all of it, it cannot in its entirety be included in his taxable income for any year" (149). Hence reiteration of these and similar irrelevant circumstances is not consistent with sound briefing. The real problem was not to determine whether petitioner controlled the fund or whether the estate's interest was half of the fund but to determine solely the value in dollars of petitioner's interest in the fund and to make that determination solely in the light of the facts as they existed in 1937.

It is even said that the taxpayer confuses valuation of an interest as distinguished from the determination of the amount of taxable income received in a given year. True, the ultimate problem is to determine the amount of the taxable income received in a given year, but, to attain that goal it is first necessary to value taxpayer's interest in the fund *and to value it as of 1937*.

If the compensation had been in the form of shares of stock having a market value, then, of course, petitioner would have been taxable on that market value as of the time of receipt. If the stock had not possessed a market value then it would have been necessary to ascertain the value of the stock under well established principles of valuation in such situations and petitioner would have been taxable accordingly. If he had sold the stock in April, 1938, at a figure above or below the 1937 valuation that would have had no relevancy on his 1937 return. The gain or loss would have to be reflected in his 1938 return.

If the compensation had been in the form of an unliquidated demand against a third party, then petitioner would have been taxable on the value of that demand at the time of its assignment to him, that is, if the facts were such as to make the demand reasonably susceptible of valuation. If there was no way to place a reasonable

valuation on this demand as of the date of assignment then taxation would have to be deferred until the transaction was closed by liquidation or otherwise. The present case is in exactly the same category. Petitioner's compensation was in the form of a claim or demand against a fund in his hands. If that claim was susceptible of valuation he was taxable in 1937 accordingly. If, as the Tax Court held, it was not susceptible of more than a theoretical or arbitrary valuation in 1937, then taxation must be postponed and the Tax Court's decision to that effect is binding on appeal (*Dobson*).

Controversies ought to be settled on their merits. That is true of all controversies. It is particularly true in this case where every fact relating to merits was before the Court. This Court has well said that

> "Courts will not permit themselves to be blinded or deceived by mere forms of law but, regardless of fictions, will deal with the substance of the transaction involved * * * as the justice of the case may require."
>
> *Chicago, Milwaukee & St. Paul R. Co.* v. *Minneapolis Civic Ass'n*, 247 U. S. 490, 501.

The federal courts have repeatedly, after quoting the above language, said that the rule "is of peculiar importance in tax cases; for, unless the courts are very careful to regard substance and not form in matters of taxation, there is grave danger on the one hand that the provisions of the tax laws will be evaded through technicalities and on the other that they will work unreasonable and unnecessary hardship on the taxpayer." (*Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695; *Early* v. *Southgate*, 136 F. (2d) 217 at 221; *True* v. *U. S.*, 51 Fed. Supp. 720, 725).

The principle announced is peculiarly applicable to the present situation. There is no suggestion on the record that petitioner has sought to evade or avoid any tax nor avail of any technicalities whatsoever and in such a situation it is highly inappropriate that technicalities should be invoked by the Government to work unreasonable and unnecessary hardship on the taxpayer.

Petitioner is entitled to have his case heard on the merits and decision reached on legal evidence.

Respectfully submitted,

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